

6-1954

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### Recommended Citation

Rau, Donovan J. (1954) "Michigan Specific Tax on Business Income," *Woman C.P.A.*: Vol. 16 : Iss. 4 , Article 2.

Available at: <https://egrove.olemiss.edu/wcpa/vol16/iss4/2>

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# MICHIGAN SPECIFIC TAX ON BUSINESS INCOME

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By DONOVAN J. RAU

*Mr. Rau, a graduate of the University of Notre Dame, worked for the Michigan Banking Department before joining the staff of the Michigan Department of Revenue in 1933. In 1949, he was appointed District Manager of the Department of Revenue, and, in 1953, received his present appointment as Director of the Specific Tax on Business Income.*

Our new tax, which the New York Times on March 7 referred to as "A Tax in Michigan Pleases Everyone," does put into practice a theory that has been advocated for many years, namely, a tax on the "added value." We do not go so far as to say that it pleases everyone, but there has been very little objection to the tax. No one is pleased with any tax, and especially so if it applies to them. This type of tax was suggested by Professor Thomas Adams at a meeting of the National Tax Association in 1917. And, in 1921, Senator Reed Smoot proposed the same type of tax at the Federal level. Since that time many tax experts have suggested the "added value" principle of taxation, but Michigan is the first state to adopt this form of taxation.

This tax recognizes the inequity of incorporating in a tax base receipts which have already been included in the tax base of another subject to the same tax.

The tax is based on the "added value" principle. The words "added value" could be defined as the receipts from goods sold, less the cost of goods and services purchased. This principle serves to avoid pyramiding of taxes by allowing a deduction at each stage for all goods and services on which taxes have been paid previously by the producers.

For example, the producer of raw material pays tax on the amount he receives for the merchandise, less his deductions such as the cost of merchandise which he has purchased for resale, plus all ordinary business expenses other than wages or depreciation, and pays tax on the value which he has added to the item.

The manufacturer pays tax on his receipts from the wholesaler, less his deductions such as the amount he has paid to the producer. The wholesaler pays tax on his receipts from the retailer, less his deductions, and the retailer pays tax on the amount he receives from the ultimate con-

sumer, less his deductions such as the amount he paid to the wholesaler and his ordinary business expenses.

The result of this type of taxation is that only the valuation added to the product by the business or industry which sells it is taxed.

To insure that no taxpayer, because of the nature of his business is less favorably treated than other taxpayers, a deduction equal to 50% is permitted any taxpayer whose deductions do not exceed that amount. This applies chiefly to a business activity engaged in rendering services and where inventories are not a factor. This feature is used by the professional group, radio stations, sporting events, and other service groups, although any taxpayer is allowed to use 50% of his gross receipts in lieu of actual business expenses.

The tax is something of a hybrid, possessing characteristics of a net income tax and a gross receipts tax, but differing fundamentally from them, as the tax base is "adjusted receipts."

Essentially the term "adjusted receipts" as defined in the act, means that the tax base is on a business payroll, profits before income tax, depreciation, and capital expenditures.

The measure of the tax is the adjusted receipts of each business enterprise subject to the tax. The statutory definition of business, activity, sales and service are as follows:

*Business:*

"The term business shall include all activities engaged in or caused to be engaged in within this state, whether in intra-state, interstate, or in foreign commerce, with the object of gain, benefit or advantage, whether direct or indirect, to the taxpayer or to another or others, but not including the services rendered by an employee to his employer or a casual or isolated transaction."

*Activity:*

"The term activity shall mean sales of property, real, personal or mixed, or the performances of services, or any combination of sales of property and performances of services."

*Sales:*

"The term sales shall mean and include the transfer of possession or of ownership, or both, for a consideration."

*Service:*

"The term service or services shall mean and include every type of endeavor other than sales."

Our definition of person or company is as follows:

"The term person or the term company herein used interchangeably includes any individual, firm, co-partnership, limited partnership, joint venture, association, corporation, receiver, estate, trust, or any other group or groups acting as a unit, and the plural as well as the singular number."

You can see by the above definitions that every business activity is subject to the tax, such as retailers, wholesalers, manufacturers, professional groups, farmers, service organizations, and every other type of business activity.

The tax applies to the entire gross receipts of a business derived from or attributable to Michigan sources, less certain deductions such as taxes other than those measured by net income, "amounts paid to any other business, the income from which is subject to the provisions of this act, or would be so subject if it was received or accrued from business conducted in the State of Michigan, or to any person or governmental agency expressly exempted from the provisions hereof for the acquisition or use of property, services, privileges or facilities for the purpose of carrying on the business, except capital assets." Rents or interest paid on the business enterprise are also deductible items, and every taxpayer is allowed a statutory deduction of \$10,000.00 per year, and the balance is the adjusted receipts which is subject to the tax at the rate of four mills.

The tax is computed in the following manner:

A grocery store with gross receipts of \$100,000.00 and having a cost of merchandise purchased for resale of \$75,000.00, plus miscellaneous expense such as rent, light, heat and taxes of \$5,000.00, would have a total deduction of \$80,000.00. It would also be allowed a statutory deduction of \$10,000.00, making the balance subject

to tax of \$10,000.00 or \$40.00 tax per year.

An example of how the tax is computed for a business not having an inventory with gross receipts of \$100,000.00, but having the same expense items, would only have a deduction of \$5,000.00. However, the law states that the taxpayer will take 50% of the gross receipts in lieu of business expenses when the business expenses do not exceed 50%. Therefore, with \$50,000.00 in deductions, plus \$10,000.00 statutory deductions, leaves him with a balance of \$40,000.00 subject to the tax or tax of \$160.00 per year.

As you will note from our definition of the term business, the act states "but shall not include the services rendered by an employee to his employer." Therefore, this tax does not apply to an employee working for wages, as his employer has paid the tax on his employee's wages.

For firms which have business activities in Michigan and one or more other states or foreign countries, the act provides a formula for apportioning adjusted receipts in order that such a firm may be assessed on that fraction of business activity attributable to Michigan. The basic principle is the ratio of receipts from its Michigan business to the total receipts of such taxpayer.

In using this formula where sales are made:

- (1) The receipts from the exclusively Michigan sales are 100% taxable.
- (2) The receipts from Michigan to out-of-state consumers are 50% taxable.
- (3) The receipts from goods "located without the state at the time of the receipt of or appropriation of orders where shipment is made to a point within the state" are 50% taxable.
- (4) Where sales of property "not located in any permanent or continuous place of business maintained by the taxpayer without the state where the orders were received or used within the state" are 50% taxable.

Thus Michigan receipts are the total sum of the receipts from intrastate business and one-half of the receipts from interstate business.

Our definition of a multistate business or one doing business in interstate commerce is as follows:

"A multistate business is a business which, in its normal course of business activities, maintains employees in, maintains a permanent place of business in, ships goods to or from, performs services in, or otherwise transacts business in at least

one state or foreign country in addition to Michigan."

As you will note, a company that has any one of the requirements can qualify as a multistate business and use the formula.

Special formulas are provided for in the act for any company engaged in the transportation business, such as railroads, truckers, lake carriers, pipe lines and airlines.

If a multistate operator has receipts derived from services, he arrives at the adjusted receipts by multiplying the total adjusted receipts by a fraction, the numerator of which is gross receipts from services rendered in Michigan and the denominator gross receipts from services rendered everywhere.

One of the most controversial problems of this or any other tax legislation, is to what extent a state can go in taxing a firm whose operations take place in several states and there is a shipment of goods and receipts over state lines.

Because our tax is entirely different from any other state tax, there is no judicial precedent established by other tax legislation. If you will refer to Supreme Court cases you will note that the opinions seem to be that states do have a right to tax out-of-state firms doing business in several states if an apportionment formula is provided for in the act.

Our act does provide for an apportionment of adjusted receipts and does not discriminate against any firm shipping across state lines. It is our firm belief that the interstate commerce clause does not intend to bar states from collecting tax from a firm just because it happens to be shipping across state lines.

Our tax gives them the same deductions as a Michigan firm, and under the apportionment formula, we only tax 50% of the receipts derived from or attributable to Michigan when the goods do cross a state line, and no attempt is made to tax their total receipts.

Certain types of business are exempt from the act, such as the State of Michigan, its agents and its instrumentalities; religious; charitable; scientific; literary or educational institutions; nonprofit associations, such as trade groups and labor unions (however, unrelated business activities are subject to the tax, such as a union operating a restaurant). Banks, trust companies and insurance companies are exempt because they are subject to a special specific tax.

Our act calls for quarterly returns, which can be a reasonable estimate, and an annual return due ninety days after the end of the

taxpayer's year. Credit is taken on the annual return for any payments made with the quarterly return. Seasonable and agricultural producers are allowed, with permission of the department, to file an annual return instead of quarterly returns.

Any taxpayer who wants to pay one year's tax in advance based on the previous year's tax can do so, and this eliminates the necessity of filing quarterly returns.

When the legislature first passed this act they had hopes that the tax would produce approximately thirty million dollars. In fact the tax was patterned to raise this amount. However, no one really knew what it would produce or how many would be subject to the tax. The first six months experience shows that the tax will produce between thirty-two and thirty-five million dollars a year, and we will have approximately eighty thousand paying tax, and about twenty-five thousand additional filing returns, but not having any tax to pay. Taxpayers with gross receipts of \$20,000.00 or less per year do not have to file, as they would not owe any tax due to the fact that they have an automatic 50% deduction in receipts and a \$10,000.00 statutory deduction, which would leave them with a zero tax base.

Briefly, the above is Michigan's new tax. If you have any specific questions please contact the writer direct at Michigan Department of Revenue, Tussing Building, Lansing, Michigan.

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tween accountants of the Americas.

Anyone desiring further information may contact Paula Reinisch, 43 Richards Avenue, N.W., Grand Rapids 4, Michigan.

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